STATE OF IOWA

DEPARTMENT OF COMMERCE

UTILITIES BOARD

IN RE: U S WEST COMMUNICATIONS, INC., n/k/a QWEST CORPORATION	DOCKET NOS. INU-00-2 SPU-00-11

CONDITIONAL STATEMENT RECONSIDERING PUBLIC INTEREST

(Issued June 7, 2002)

On February 10, 2000, the Utilities Board (Board) issued an order initiating an investigation relating to the possible future entry of U S WEST Communications, Inc., n/k/a Qwest Corporation (Qwest), into the InterLATA market. The investigation was identified as Docket No. INU-00-2.

The Board issued an order dated August 10, 2000, indicating that its initial review of Qwest's compliance with track A (competition issues), various aspects of each item on the 14-point competitive checklist, § 272 (separate subsidiary) issues, and public interest considerations would be through participation in a multi-state workshop process with the Idaho Public Utilities Commission, North Dakota Public Service Commission, Montana Public Service Commission, Wyoming Public Service Commission, and the Utah Public Service Commission. Since the time of that order, the New Mexico Public Regulation Commission has also joined in the workshop process.

On October 22, 2001, Liberty Consulting Group (Liberty) filed a report addressing issues raised by workshop participants related to the public interest of Qwest's future entry into the in-region InterLATA market.[1] On January 25, 2002, the Board issued a conditional statement concluding that, subject to the recommendations contained in its conditional statement, Qwest had conditionally satisfied the issues relating to public interest.

AT&T Communications of the Midwest, Inc., and AT&T Local Services on behalf of TCG Omaha (collectively, AT&T) filed comments on February 14, 2002, in response to the Board's January 25, 2002, conditional statement. In its comments, AT&T again argued that Qwest's unbundled network element (UNE) prices are so high as to present an insurmountable barrier to competition and urged the Board to reconsider this issue based on a D.C. Circuit, Court of Appeals opinion issued December 28, 2001, in *Sprint Communications Co. L. P. v. Federal Communications Comm'n*, 274 F.3d 549 (D.C. Cir. 2001) (*Sprint*). The Court in *Sprint* directed the FCC to reconsider the issue of whether evidence of a price squeeze would preclude profitable competitive local exchange company (CLEC) competition.

On February 19, 2002, the Consumer Advocate Division of the Department of Justice (Consumer Advocate) filed a motion requesting the Board reconsider its January 25, 2002, determination that Qwest had conditionally met the public interest

[1] This report was prepared by the "outside consultant," The Liberty Consulting Group (Liberty), which was retained to assist the state commissions collectively by making recommendations for resolution of impasse issues.

requirement. Additionally, Consumer Advocate requested that the Board schedule an oral argument on this issue to consider the effect of the Sprint order on the public interest issue.

Qwest responded to the comments of AT&T and Consumer Advocate's motion on February 28, 2002. In its response, Qwest notes that the D.C. Circuit remanded so that the FCC could either "pursue [AT&T's] price squeeze claim or at the very least explain why the public interest does not require it to do so."[2] Qwest urged the Board to dismiss the request for oral argument and the reconsideration requested by AT&T, arguing that the Sprint order was not applicable in this situation because the evidence was evaluated and rejected on the merits of the evidence presented.

AT&T filed further comments and an offer of supplemental authority regarding the public interest issue on March 5, 2002.

The Board issued an order on March 8, 2002, granting the request for an oral argument and setting time parameters for that argument. Participants appeared on March 14, 2002, and the Board has now considered the arguments presented related to the issues presented.

AT&T and Consumer Advocate have asked the Board to reconsider four issues pertaining to the public interest of Qwest's entry into the in-region InterLATA market. Each issue is addressed individually below.

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[2] Id. at 554.

1. UNE Price Squeeze

AT&T continues to maintain that UNE prices are so high they present an insurmountable barrier to competition.[3] The Boards conditional statement issued January 25, 2002, adopted Liberty's conclusion, and the FCC's position, that "the issue of whether UNE prices are too high for CLECs to make a profit is not relevant to the public interest inquiry."[4] *Sprint* appeared to vindicate AT&T's position by requiring the FCC to give a more thorough consideration to the issue. Consumer Advocate also cited *Sprint* and noted that the court could not uphold the FCC's public interest analysis with regard to UNE prices.[5]

Qwest maintained that AT&T and the OCA misconstrued *Sprint*.[6] In remanding the *SBC Kansas/Oklahoma Order*, the D.C. Circuit simply expressed concern about what it perceived as a "brush-off" of AT&T's price squeeze claim. It remanded so the FCC could either "pursue [AT&T's] price squeeze claim, or at the very least explain why the public interest does not require it to do so."[7] This was not a "vindication" of AT&T's position, but a procedural remand for a clearer explanation of the reasoning behind the denial of AT&T's argument.

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[3] Comments of AT&T in Response to the Board's Conditional Statement Regarding Public Interest and Track A, Docket Nos. INU-00-2 and SPU-0011, filed February 14, 2002.

[4] Conditional Statement, pp. 15-16.

[5] Motion for Reconsideration and Request for Oral Argument, Docket No. INU-00-2, filed February 19, 2002.

[6] Qwest's Response to AT&T's Comments on and the Iowa OCA's Motion for Reconsideration of the Board's Conditional Statement Regarding Public Interest and Track A, Docket No. INU-00-2, filed February 28, 2002.

[7] *Sprint*, 274 F.3d, at 554.

To date, the FCC has not responded broadly to *Sprint* with an order directly addressing the remand, but it has approved three section 271 applications subsequent to the release of the *Sprint* decision. In each of those orders the FCC ruled narrowly as to whether a UNE price squeeze existed in specific states.

The Colorado Public Utilities Commission has issued an order addressing the question of whether a UNE price squeeze exists in Colorado in light of *Sprint*.[8] The analysis in the Colorado order addresses the issue broadly while at the same time incorporating analysis provided by Liberty's October 22, 2001, report on the public interest issue.

Sprint, like AT&T, had argued that low penetration of residential service was an indicator that UNE rates did not conform to TELRIC pricing. Because rates were too high, according to Sprint, SBC was engaged in a "price squeeze." The D.C. Circuit agreed with Sprint that the FCC "should pursue their price squeeze claim, or at the very least explain why the public interest does not require it to do so."

The failure of the FCC to explain its decision in *Sprint* does not necessarily compel a conclusion that a price squeeze exists in Iowa. Liberty noted that AT&T "did not recognize that local rates consist of much more than the basic monthly charge for service. Vertical features and intrastate toll revenues must be considered."[9]

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8 Colorado Public Utilities Commission, *Order on Staff Volume VII Regarding Section 272, the Public Interest, and Track A, dated March 15, 2002, pp. 32-42*

9 Liberty's Public Interest Report, p. 5.

Liberty pointed to other avenues of market entry such as resale, business lines, and the subsidies that are available to those competitors who service qualifying residential lines through facilities-based competition. These avenues of entry, along with bundled services over UNE-P, would maximize consumer and producer welfare.

As Liberty noted in its report, AT&T's analysis did not consider the existence of resale as an option for certain service classes that do not lend themselves to economical competition through the use of UNEs, a situation recognized by the *Sprint* Court.

> Second, if the commission is correct in reading Track A to require only a minimal volume of competition to be present, see Order ¶ 42, and that reading is not challenged here (though its application is), it may reflect a recognition that the residential market may not be attractive to competitors even if UNE costs are at the lower end of TELRIC (assuming it to have a material range).

The allegation of a price squeeze counsels two things: (1) consider the residential retail rate when setting UNE-P rates, and (2) consider the public interest repercussions of the rate differential between wholesale and retail. The first is a costing docket consideration, but the second is relevant here.

The remand in *Sprint* resulted because of a failure by the FCC to fully explain its reasoning in rejecting the price squeeze argument in its order. Conversely, the Board fully discussed the price squeeze argument in its conditional statement.[10] The Board concluded that based on previous FCC orders, the issue of whether UNE

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[10] *In Re: U S WEST Communications, Inc., n/k/a Qwest Corporation,* Conditional Statement Regarding Public Interest and Track A, Issued January 25, 2002, pp. 14-16.

prices are too high for CLECs to make a profit is not relevant to the public interest inquiry and thus it made no determination on the issue.

Because there are other modes of residential market entry, and because CLECs have not quantified with any precision the extent of and harm from an alleged price squeeze, the Board determines that the public interest test is still met despite *Sprint*.

The Board rejects the claim that a UNE price squeeze contravenes the public interest of Qwest's entry into the InterLATA market.

2. Intrastate Access Price Squeeze

AT&T complained that the Board relied on the FCC's *Supplemental Order Clarification* to dismiss AT&T's arguments that exorbitant access charges would result in a price squeeze. AT&T suggested that the Board seemed convinced that the FCC's language, quoted in its conditional statement, would serve as a guarantee against a price squeeze.[11]

AT&T noted, that upon being granted section 271 authority in Texas, Southwestern Bell Telephone (SWBT) entered the InterLATA market with long distance rates of 6 cents per minute even though access charges were 5.8 cents per minute. SWBT captured nearly 20 percent of the Texas long distance market, but six months later SWBT raised rates from 6 cents to 8 cents per minute. After the rate increase, SWBT was still able to add new customers and increase the number of

[11] Conditional Statement, p. 18.

lines it served with InterLATA service.

AT&T predicted that if Qwest enters the InterLATA market, without first reducing access charges, it would bundle local and long distance service like SWBT. AT&T argues that Qwest could then set its InterLATA rates close to its price for switched access and squeeze competitors out of both markets, causing the re-monopolization of local and long distance markets.

Qwest suggested that AT&T was attacking the section 272 structural and non-discrimination requirements. Qwest maintains the requirements provide adequate safeguards against any effort by an incumbent to obtain an unfair competitive advantage in the long distance market by discriminating against unaffiliated interexchange carriers (IXC) or by improperly allocating costs or assets between itself and its long distance affiliate.[12]

Without offering any evidence pertinent to Iowa, AT&T charged that "Qwest's exorbitant intrastate access rates, priced significantly above cost, provide it with a source to subsidize its other products and services."[13] Qwest's Iowa access rates have been reduced twice in recent years and they are among the lowest in the fourteen-state region. Iowa Code § 476.3 allows for complaints regarding unreasonable access charges. No complaints have been filed with the Board.

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[12] *See* First Report and Order, *Access Charge Reform*, 12 FCC Rcd 15982 ¶ 279 (1997) ("Access Charge Reform Order"), *aff'd*, *Southwestern Bell Tel. Co. v. FCC*, 153 F.3d 523, 548 (8th Cir. 1998) (rejecting the same "price squeeze" argument); Supplemental Order Clarification, *Implementation of the Local Competition Provisions Of the Telecommunications Act of 1996*, 15 FCC Rcd 9587 ¶ 19-20 (2000) (*Supplemental Order Clarification*).

[13] Comments of AT&T, filed February 14, 2002, page 4.

Qwest noted that AT&T argues consumers would prefer to purchase local and long distance services from the same company. AT&T also argues that once a Bell company receives section 271 authorization, it would have an advantage in providing both services unless IXCs could provide residential competition through UNE-P. Missing from AT&T's argument is any identification of harm to the public interest. Qwest suggests that if consumers consider themselves to be better off when they can purchase local and long distance services from the same carrier, a reason for granting section 271 approval results - not a rationale to deny it.

AT&T did not raise this issue at the oral argument and Qwest made only a cursory reference to it. (Tr. 46). However, there appears to be three factors that counter AT&T's claim of an intrastate access price squeeze.

First, the section 272(e)(3) imputation requirement precludes Qwest from charging its long distance affiliate lower access rates than it charges a competing IXC. It has been the position of both Congress and the FCC that the section 272-imputation requirement provides "adequate safeguards against any effort by an incumbent to obtain an unfair competitive advantage in the long distance market."[14]

Second, Qwest's Iowa access rates are relatively low. AT&T's comparison of intrastate access rates, filed in the multi-state collaborative for the seven participating states, showed access rates ranging between 2.5 cents and 9.83 cents per minute.[15] Iowa's rates were second lowest at 3.98 cents per minute. The Texas price squeeze,

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[14] *Supplemental Order Clarification*, ¶ 19.
[15] Affidavit of Mary Jane Rasher Regarding Track A and Public Interest, filed May 4, 2001, page 11.

referenced by AT&T, compared SWBT's 5.8 cents per minute access rates to SWBT's 6 cents per minute long distance rates. Because Iowa's access rates are substantially less than those in Texas, allegations of an Iowa price squeeze are less convincing.

Third, the impact of access charges can be reduced through a facilities-based market entry strategy. IXCs pay access charges to the local exchange carrier when connecting to the local network. The purpose of access charges is to help offset the cost of the local network. When a CLEC provides service through a resale entry strategy, IXCs connecting to the local network pay access charges to the incumbent local exchange carrier (ILEC) instead of the CLEC.[16] However, when a CLEC provides service through a facilities-based entry strategy, IXCs pay access charges to the CLEC instead of the ILEC. Qwest noted at the oral argument that, if AT&T entered the local exchange market via UNE-P, AT&T would be a facilities-based CLEC. (Tr. 46).

The Board rejects AT&T's claim that Qwest's intrastate access charges present a price squeeze significant enough to contravene the public interest.

3. Prior Qwest Conduct

AT&T argued that Qwest has engaged in a variety of strategies to frustrate its competitors.[17] AT&T cited the February 22, 2002, recommended decision by the ALJ

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[16] *Local Competition First Report and Order,* released August 8, 1996, ¶ 980.
[17] AT&T's Offer of Supplemental Authority Regarding Public Interest, Docket Nos. INU-00-2 and SPU-00-11, filed March 5, 2002.

of the Minnesota Public Utilities Commission. The recommended decision would penalize Qwest nearly $1.2 million for delays in providing UNE-P testing.

AT&T stated the ALJ's decision characterizes the violation as a continuing pattern of conduct and that Qwest deliberately fabricated evidence in an attempt to assert that AT&T did not intend to enter the local exchange market in Minnesota. According to AT&T, these findings demonstrate an ongoing pattern of anti-competitive behavior by Qwest and a willingness to subvert the ability of a regulatory body to determine the true facts at hand. AT&T submits this showing is predictive of future behavior and current safeguards do not protect competitors or the public from this course of behavior.

Qwest responded that AT&T points to an interim decision that has no "legal effect" and is under appeal.[18] This is a complaint that Liberty and the Board previously considered and found not to present any concern with respect to the public interest inquiry. The complaint does not involve any conduct in Iowa or a complaint before the Board. Nevertheless, the Board has already approved SGAT language designed to prevent similar concerns from occurring again.

AT&T responded to Qwest's reply by suggesting that the ALJ's recommended decision brings to light a series of bad acts and improper conduct on the part of

[18] Qwest's Response to AT&T's Offer of Supplemental Authority Regarding Public Interest, Docket No, INU-00-2, filed March 12, 2002.

Qwest.[19] Importantly, according to AT&T, Qwest has not denied any of the factual conclusions set forth by the ALJ. Qwest contends that the underlying problem was resolved by putting language in the SGAT. However, similar language was first placed in statute in Minnesota. If Qwest is willing to violate a statute, what assurance is there that it will comply with the SGAT? Liberty held that past actions are not predictive of future actions. AT&T suggests that Liberty's conclusion is wrong, arguing that the recommended decision encapsulates Qwest's strategy for dealing with competitors. AT&T asserts that by closing its eyes to the past, Liberty risks a blind acceptance of future and similar behavior.

At the oral argument, AT&T stated it would not be appropriate for the Board to recommend section 271 approval, at the present time, based on the Minnesota UNE-P testing complaint. (Tr. 10-11). AT&T's position appears to be that the Minnesota ALJ's recommended penalty was insufficient. Therefore, other states need to supplement the nearly $1.2 million proposed penalty by indefinitely withholding section 271 approval.

The Board notes, however, the ALJ in Minnesota did not recommend withholding section 271 approval in Minnesota. Thus, it may be assumed the ALJ considered the penalty, alone, appropriate for the anti-competitive actions Qwest allegedly performed. Not withstanding the fact that the Minnesota Commission has

[19] Reply to Qwest's Response to AT&T's Offer of Supplemental Authority Regarding Public Interest, Docket Nos. INU-00-2 and SPU-00-2, filed March 29, 2002.

yet to affirm the ALJ’s penalty, there is no precedent for the Board to add its own penalty to a complaint proceeding that occurred elsewhere on a record not before it.

The fact that AT&T prevailed, at least initially, demonstrates there are procedures in place for addressing wholesale complaints. The ALJ’s proposed decision shows that significant penalties, imposed through traditional regulatory complaint proceedings, are useful in guarding against anti-competitive behavior.

After Qwest obtains section 271 approval, QPAP penalties will also guard against anti-competitive behavior. Under the QPAP, Qwest’s failure to meet the performance indicator definitions (PIDs) will trigger automatic penalties, because any failure to meet the PIDs would interfere with the ability of other wholesale customers to compete. Therefore, after section 271 approval, regulatory oversight and sanctions towards anti-competitive behavior should increase. Similarly, Qwest’s incentive not to engage in anti-competitive behavior should also increase.

To determine whether past actions of Qwest would contravene the public interest, the Board enunciated a burden of proof "that past behavior must be predictive of future behavior."[20] Based on the ALJ’s proposed decision, it is hard to envision Qwest, in the future, undertaking actions in Iowa similar to those that precipitated the complaint in Minnesota.

The Board denies AT&T’s motion to withhold Qwest’s section 271 approval, based on the Minnesota UNE-P complaint proceeding.

[20] Conditional Statement, page 27.

4. Level of Competition

Consumer Advocate argued the Board could not properly consider the public interest condition, in light of *Sprint,* merely by reconsidering the portion of its public interest analysis concerning UNE prices. UNE prices are part of the whole that is public interest. Therefore, the Board must go further and reconsider the public interest as a whole. Congress expressly left the door open to the FCC and Board to consider all things relevant to achieving Congressional goals including the extent of actual competition and its significance under principles of anti-trust law.[21] According to Consumer Advocate, previous statements by the FCC, and now the Board, that limit the scope of the public interest inquiry are legally erroneous and must be corrected.

Qwest argued that Consumer Advocate's interpretation of *Sprint* badly misconstrued the court's ruling when it advocated an entirely new public interest inquiry. The FCC has declared repeatedly that there is no market share test in the public interest analysis.[22] The D.C. Circuit did not address this well-established element of the FCC's public interest test. Thus, it is untenable to suggest that not only this FCC policy, but also all other FCC decisions that "limit the scope of the

[21] *Goldwasser v. Ameritech Corp*., 222 F.3d 390, 391 (7th Cir. 2000) ("Congress . . . entrusted the . . . Commission . . . and the state public utility commissions with the task of overseeing the transition from the former regulatory regime to the Promised Land where competition reigns, consumers have a wide array of choice, and prices are low").

[22] *Verizon Rhode Island Order* released February 22, 2002, ¶ 104.

public interest inquiry," are "legally erroneous and must be corrected."[23] The D.C. Circuit said no such thing. It narrowly remanded for further consideration by the FCC of the relevance, if any, of retail "margin" analysis for UNE-based competition. In Iowa, that analysis has already been performed by Liberty and adopted by the Board.

At the oral argument, Consumer Advocate acknowledged that Congress rejected a market share test for compliance with Track A. (Tr. 19). For the public interest analysis, Consumer Advocate maintained that the FCC had misconstrued Congressional intent by ignoring a market share requirement. (Tr. 20). The Consumer Advocate made the same arguments, prior to *Sprint,* in the multi-state collaborative. In light of *Sprint*, Consumer Advocate asks the Board to "suggest to the FCC that it must weigh the lack of competition in Iowa when it makes its decision on the public interest, and . . . . the public interest in Iowa will not be served by allowing Qwest into the long-distance market because Qwest still controls 85 percent of the local market." (Tr. 27-28).

Qwest stated that the Board should consider paragraph 427 of the *Bell Atlantic New York Order*. The FCC articulated its position that to deny section 271 authority, under the public interest test, the BOC must be guilty of a "sin of omission or commission." (Tr. 39). Since Qwest did not set UNE rates, the level of competition resulting from UNE rates, is no sin of omission or commission on Qwest's part.

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[23] OCA Motion, page 4.

The *Verizon Rhode Island Order* provided a discussion of the "statutory requirements" for the public interest inquiry of 47 U.S.C. § 271(D)(3)(C). The FCC stated the public interest inquiry is:

> [A]n opportunity to review the circumstances presented by the application to ensure that no other relevant factors exist that would frustrate the Congressional intent that markets be open, as required by the competitive checklist, and that entry will therefore serve the public interest as Congress expected.[24]

In its January 25, 2002, conditional statement, the Board adopted Liberty's position that "[S]ection 271 can be met in a empty room, provided there is certainty that the door to the room has been unlocked."[25] Implicitly, Consumer Advocate takes issue with the "empty room" metaphor contending that Congressional intent was for the room to be filled with more competitors than currently exist in Iowa. The Consumer Advocate wants the Board to support "a quest to change the rules of the 271 approval process in midstream." (Tr. 67).

Beyond the issue of interpreting *Sprint*, which is addressed above, is the issue of interpreting Congressional intent for the public interest inquiry. The issue for the Board to reconsider is whether Congress intended that section 271 could be met in an "empty room." An analysis of 47 U.S.C. § 271(c)(1)(B), or Track B, which has not been addressed in this proceeding, is useful for interpreting Congressional intent.

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[24] *Verizon Rhode Island Order*, Appendix D, ¶ 71.
[25] Conditional Statement, page 21.

The following discussion of Track B is found under the "statutory requirements" section of the *Verizon Rhode Island Order*:

> As an alternative to Track A, section 271(c)(1)(B) permits BOCs to obtain authority to provide in-region, InterLATA services if . . . .no facilities-based provider . . . .has requested the access and interconnection arrangements . . . ., but the state has approved an SGAT that satisfies the competitive checklist of subsection (c)(2)(B). Under section 271(d)(3)(A)(ii), the Commission shall not approve such a request for in-region, InterLATA service unless the BOC demonstrates that, "with respect to access and interconnection generally offered pursuant to [an SGAT], such statement offers all of the items included in the competitive checklist." Track B, however, is not available to a BOC if it has already received a request for access and interconnection from a prospective competing provider of telephone exchange service. [26]

For states such as Iowa, Track B does not apply because competitors already exist. Therefore, Iowa is subject to the requirements of Track A. However, it would appear that if no competitors existed in Iowa, Qwest could still obtain section 271 approval by virtue of an approved SGAT offering all items of the competitive checklist.

Based on the statutory requirements of Track B, it would appear that Congress intended that "[s]ection 271 can be met in a empty room, provided there is certainty that the door to the room has been unlocked." Therefore, it does not appear that Congress could have intended any market share test to be applied to the public interest inquiry.

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[26] *Verizon Rhode Island Order*, Appendix D, ¶ 16.

The Board rejects the claim that the public interest inquiry of 47 U.S.C. § 271(d)(3)(C) requires a market share test.

IT IS THEREFORE ORDERED:

Any responses to this statement and all future filings and Board orders or statements in this docket must be filed no later than close of business on the third business day following the filing or issuance.

UTILITIES BOARD

/s/ Diane Munns

/s/ Mark O. Lambert

ATTEST:

/s/ Judi K. Cooper
Executive Secretary

/s/ Elliott Smith

Dated at Des Moines, Iowa, this 7th day of June, 2002.